

Taxation and Valuation of Leasehold Interests in Exempt Real Property

Tax on Intangible Personal Property	Local property tax applies to leasehold interests in real property where the real property is exempt from property tax. The only forms of intangible personal property subject to local property tax are leasehold interests in exempt real property and certain computer software.
2012 Session	Reports of inconsistent application of the tax by different counties resulted in Section 2 of Session Law 2012-189 (HB 1181) placing the issue before the Revenue Laws Study Committee.
Issue	Whether local property tax applies when a governmental unit leases real property to a private business under a lease with below market rent.
What Property Is Subject to Tax?	The property subject to tax is the intangible interest under the lease with a governmental unit. The real property owned by the governmental unit is not subject to tax regardless of the use of the property.
Who Pays the Tax?	Party leasing real property from a governmental unit.
Valuation	Most county assessors value these leasehold interests as the difference between the fair market value of the leasehold interest and the rent paid under the lease.
Examples	<p><u>Lease at Market Rate:</u> If the private tenant is paying market rate for the exempt real property owned by a local government, then the leasehold interest has no value because similar leases can be obtained at the same price.</p> <p><u>Lease below Market Rate:</u> If the tenant is paying a bargain rate under the lease, the leasehold interest has value because a similar lease would cost more.</p>
Discussion	<p><u>Lease Between Private Parties:</u> The lease does not affect the valuation of real property for tax purposes, and the property tax bill is not divided between the landlord and tenant. The tax bill is simply due in full. Private parties often agree in the lease how to allocate the tax bill.</p> <p><u>Lease with Governmental Unit:</u> When the land is not subject to property tax (i.e., exempt real property), the value of the lease is divided between the exempt landlord and the nonexempt private party. If the tenant is paying a bargain rate under the lease, the leasehold interest has value because a similar lease would cost more. Taxing the leasehold interest prevents the private party from receiving tax-exempt status on land.</p>
Statutory References	<p><u>G.S. 105-275(31):</u> exempts intangible personal property other than a leasehold interest that is in exempt real property.</p> <p><u>G.S. 105-275 (31e):</u> exempts leasehold interests in real property that is exempt under G.S. 105-278.1 and is used to provide affordable housing for employees of the unit of government that owns the property.</p> <p><u>G.S. 105-278.1(b):</u> exempts real and personal property owned by State and local governments from property tax.</p>